

APPENDIX.

THE STATUTE INVOLVED.

Revenue Act of 1918 (40 Stat. 1057-1060) :

“Sec. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.”

THE REGULATIONS INVOLVED.

Regulations 45 (1920 Edition) :

“Art. 1582. *Valuation of inventories.* . . . Inventories must be valued at (a) cost or (b) cost or market, as defined in Article 1584 as amended, whichever is lower. (See articles 1585 for inventories by dealers in securities.) Whichever basis is adopted must be applied consistently to the entire inventory. A taxpayer may, regardless of his past practice, adopt the basis of ‘cost or market, whichever is lower’, for his 1920 inventory, provided a disclosure of the fact and that it represents a change is made in return. Thereafter changes can be made only after permission is secured from the Commissioner. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased.”

“Art. 1584. *Inventories at market.* . . . Under ordinary circumstances, ‘market’ means the current bid price pre-

vailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where, owing to abnormal conditions, the taxpayer has regularly sold such merchandise at prices lower than the current bid price as above, defined, the inventory may be valued at such prices, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. Goods in process of manufacture may be valued for purposes of the inventory on the lowest of the following bases: (1) the replacement or reproduction cost prevailing at the rate of the inventory; or (2) the proper proportionate part of the actual finished cost; or, under abnormal conditions, (3) the proper proportionate part of the sales price of the finished product, account being taken in all cases of the proportionate part of the total cost of basic elements (materials, labor and burden) represented in such goods in process of manufacture at the stages at which they are found on the date of the inventory. The in-

ventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted. He must be prepared to show both the cost and the market price of each article included in the inventory. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of Section 214(a) (12) or Section 234(a) (14) of the statute. See Articles 261-268."

